No. 13,147

IN THE

United States Court of Appeals

For the Ninth Circuit

ESTATE OF MABEL COCHRAN, Deceased; SIDNEY ELMER COCHRAN and DONALD ROBERT COCHRAN, Executors, and JOSEPH E. COCHRAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

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ARGUMENT.

Respondent's brief makes it patently clear that there is no dispute with the petitioners regarding the material facts of the controversy as found by the Tax Court. Practically all of the material evidence was stipulated; there was no conflict in the testimony of the witnesses; there was no fact found by the Tax Court which varied from the testimony of the witnesses. Under these circumstances there is no question of credibility of witnesses involved. Nor does the

Tax Court's statement, to which respondent attaches importance (R.B. 21, 22), that its decision was arrived at from a consideration of the entire record, add anything of significance, for presumably all decisions of the Tax Court, whether correct or otherwise, are made after a consideration of the record, in its entirety and not in part.

However, it is the findings of fact of the Tax Court which lie at the base of the Tax Court's decision. In the case at bar, the Tax Court's ultimate finding of fact is nothing more nor less than its ultimate decision of law, and it is submitted that its ultimate finding of fact is not the kind of finding to be set aside for clear error as provided in Rule 52(a) of the Federal Rules of Civil Procedure. On the contrary, the ultimate finding of fact is actually a conclusion of law, the ultimate finding here being that Bernice Cochran Johnson and Winifred Cochran Irwin were not valid partners in the partnership business of Cochran & Celli during the years 1942, 1943 and 1944. (R. 191.) The predicate for this ultimate finding is the finding or conclusion that there was no bona fide intent on the part of the copartners of Cochran & Celli, either when the partnership was formed or at any other time during the taxable years 1942, 1943 and 1944, that the two Cochran daughters were to be joined with the other members of Cochran & Celli for the purpose of carrying on business as a partnership. It is submitted that this predicate is of the character of a mixed finding of fact and conclusion of law. It is a conclusion of law in this instance because it fol-

lows from findings of fact based upon the undisputed facts in this case; and such findings are accepted by petitioners. The rule of clear error prescribed in Rule 52(a) of the Federal Rules of Civil Procedure is therefore not applicable to this appeal because there is no claim that any of the findings of fact should be set aside.

The issue presented by respondent's brief therefore is actually whether the Tax Court was legally correct in deciding that from its findings of fact and the stipulated facts, it was obliged to conclude that there was no bona fide intent that the two Cochran daughters be joined as partners because from the facts found there did not appear to be any business purpose for bringing either of the two daughters into the partnership in the year 1937, and more particularly that in the years involved, viz., 1942, 1943, and 1944, there was no business purpose for including either of the two daughters in the partnership.

Or, putting it another way, respondent's brief presents the issue whether the Tax Court was legally correct in deciding that there was no such bona fide intent because the daughters did not contribute as capital to the partnership, property originating with them independently of their parents, but, on the other hand, contributed as capital property which they acquired by gift from their parents, capital already in the business. It is recognized, of course, that the question of bona fide intent in such a case is affected by the other facts found by the Tax Court. However, it is submitted that all of the other facts are not only

consistent with but affirmatively and effectively prove the claim of the petitioners that there was a bona fide partnership.

A significant fact throwing light on the question is that the Tax Court recognized (R. 192) that the gifts of capital to the daughters by the parents were bona fide completed gifts, particularly in respect to the years involved, viz., 1942, 1943 and 1944, which, for the purpose of this controversy, are controlling; and that further, in the years involved the Tax Court specifically found that both daughters made personal use of the profits from the business of Cochran & Celli attributed to their capital in the partnership. (R. 191, 192.)

It is submitted, therefore, that contrary to the assertion made by respondent that the petitioners overlooked their burden of proof, the findings of fact of the Tax Court and the undisputed evidence, including the stipulated facts, underlying such findings of fact sustain and compel an ultimate finding that the daughters were true partners during 1942, 1943 and 1944, and that there was a bona fide intent on the part of the copartners of Cochran & Celli to include the daughters as members of the partnership of Cochran & Celli for the purpose of carrying on business as a partnership. (R.B. 20.)

Petitioners have no reason to disagree with this court's decision in *Harkness v. Commissioner,* 193 F. (2d) 655, 658 (C.A. 9th) (petition for writ of certiorari denied), which is clearly distinguishable on its

facts from the case at bar. In *Harkness,* the primary contribution of the children was intended to be the services of the son and the daughter's husband, and such services were obviously not expected until the future when the son and son-in-law would be discharged from the armed forces. There was no gift of present capital by the parents to the children. On the other hand, the capital in the business ascribed to the children was to be acquired by them by payment from the profits of the business to be allocated to them. Furthermore, the alleged need for additional capital in the business was obviously to be supplied principally by accumulation of profits from tax savings on the income to be allocated to the children. Still further, it was found by the Tax Court that one of the reasons for the organization of the partnership was the taxes to be saved from the allocation of income to the son and daughter. On these facts, the Tax Court held, and such holding was affirmed by the Circuit Court, that although there was an intention to form a partnership it was not a present partnership but a partnership to come into existence in the future when the services contemplated would be available.

In the case at bar there was no finding and it was not the case that any tax savings were contemplated. In 1942, 1943 and 1944, the years involved herein, the ownership of capital by Bernice Cochran Johnson and Winifred Cochran Irwin was well entrenched; each year their capital was reinvested under the terms

of the partnership agreement. In 1942, 1943 and 1944 the partnership was five years, six years, and seven years old. The daughters had and exercised the enjoyment of the income attributable to their capital. Their capital in the business served an important business function in the production of the income (see R.B. 24), and the inclusion of the daughters in the partnership business in those years was therefore very material.

Though there are no findings of fact on the subject by the Tax Court, respondent, nevertheless, raises the suggestion that the amounts paid as salaries to the working partners, including the Celli members, may have been unreasonably low for their services and that this would be important in the consideration of the existence of a bona fide partnership intent. (R.B. 28.) It is submitted that the Tax Court of course made no such finding. Furthermore, the record reveals that the salaries that were paid were agreed upon among the partners, including the Celli members, after due consideration and the amounts were fixed according to what was considered right. (R. 110, 111.)

The court's attention is called to further consideration given to the "family partnership" by the Circuit Court of Appeals, Fifth Circuit, in *L. W. Seabrook v. Commissioner* (Decision No. 13,677, April 18, 1952, P-H Tax Service Par. 72,411). The Fifth Circuit has again decided in line with its recent reversal of the Tax Court in *Culbertson et al. v. Commissioner of*

Internal Revenue, 194 F. (2d) 581, that the Tax Court, despite the admonition in *Commissioner v. Culbertson,* 337 U.S. 733, "has continued in its adherence to the view that it is essential to membership in a family partnership for tax purposes that the capital contributed be 'original capital' or that the partners contribute 'vital services' or participate in the management and control of the business." It is the conclusion of the court in *Seabrook v. Commissioner,* supra, that the Tax Court determined erroneously that the absence of "original capital" in a family partnership was itself decisive of the lack of bona fide intent to form a partnership. A fair reading of the decision of the Tax Court in the case at bar justifies the same conclusion, and it is only on this premise that the Tax Court's decision in this case can be really understood.

Petitioners refer the court to their opening brief for reply to the other discussion in respondent's brief.

CONCLUSION.

It is submitted to this court that the Cochran & Celli partnership, including the daughters, not being a sham or subterfuge and not having been availed of for tax purposes, and not being a mere temporary re-allocation of income within a family, but having been formed some years ago for an honest purpose real to the parties, which gave equal recognition to the capital and earnings of the Cochran daughters,

the fruits of which were actually enjoyed by them, should be recognized as a valid partnership for tax purposes; that the Tax Court was clearly in error in attaching a controlling and erroneous significance to the fact that the capital invested in the partnership by the Cochran daughters in 1942, 1943 and 1944 was derived from capital that was obtained by them as gifts from their parents in 1937.

Dated, San Francisco, California,
May 26, 1952.

Respectfully submitted,
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